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WILL BIG TOBACCO SEEK BANKRUPTCY PROTECTION? A \$145 BILLION VERDICT POSES THE QUESTION

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The wave of tobacco litigation that began in 1994 with the emergence of secret, damning internal industry documents,¹ charges of nicotine manipulation,² and the memorable congressional testimony of Big Tobacco's CEOs,³ has finally come ashore in the form of nearly \$400 billion in judgments and settlements.⁴

This seemingly staggering amount may only be the beginning as the beleaguered tobacco industry faces an increasingly full trial calendar over the next several years. Tobacco companies continue to place their faith in their appellate track record and ability to generate colossal cash with price increases. But in the face of such staggering debts and future liability, the time has come to ask whether Big Tobacco might ultimately be forced to seek Chapter 11 relief in a bankruptcy court? If the answer is yes, that court would be faced with a uniquely difficult task.

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¹ STANTON A. GLANTZ ET AL., *THE CIGARETTE PAPERS* (1996).

² *Day One: Smokescreen, Part One* (ABC News television broadcast, Feb. 28, 1994).

³ See *Nicotine and Cigarettes: Hearing Before Subcomm. On Health and the Env't of the House Comm. on Energy and Commerce, 103d Cong.* (1994) (statements of seven Big Tobacco CEOs), available at <http://www.pbs.org/wgbh/pages/frontline/shows/settlement/timelines/april94.html> (last visited Dec. 1, 2001).

⁴ Figure arrived at by adding 25 years of estimated payments to states based on the Master Settlement Agreement and individual settlements by the remaining four states (Mississippi, Florida, Texas, and Minnesota), and the \$145 billion punitive damages verdict in a Florida class action that is currently under appeal.

I. THE \$145 BILLION VERDICT

On the 211th anniversary of the Bastille prison uprising that signaled the birth of the French Revolution, a Florida jury in the *Engle* class action trial⁵ may have started a litigation revolution of its own by issuing a jaw-dropping punitive damages verdict against the tobacco industry totaling approximately \$145 billion.⁶

This unprecedented punitive damage award came in the third round of verdicts handed down by the *Engle* jury. A year earlier, the six jurors found that cigarette smoking caused twenty diseases, and that the five cigarette manufacturer defendants individually and in conspiracy with each other and two trade groups they had created committed a variety of torts, including fraud and fraudulent concealment.⁷ Then, in April 2000, the same jury found the defendants liable to three individual class members, utterly rejecting the industry's claim that two of the class members had the same rare form of lung cancer not related to smoking, while the third developed his throat cancer from exposure to wood dust rather than his many years of smoking.⁸ The jury awarded the plaintiffs compensatory damages for medical expenses, lost wages, and pain and suffering averaging more than \$4 million each.⁹

Unless the class is decertified or the verdicts reversed on appeal, the trial will continue to its next phase. In the fourth and final phase of the trial plan, the court must devise an expedited process to determine class membership and compensatory damages for individual putative class members. If an individual were successful, he or she would likely receive a share of the punitive damages.¹⁰ If the original jury's compensatory award is extrapolated to the 250,000 or more estimated ill or deceased Florida smokers comprising the class, the industry's obligation just to

⁵ *Engle v. R.J. Reynolds Tobacco Co.*, No. 94-08273 CA-22, 2000 WL 33534572 (Fla. Cir. Ct. Nov. 6, 2000).

⁶ The verdict breaks down among tobacco companies as follows: Philip Morris, Inc.—\$73.9 billion; R.J. Reynolds Tobacco Co.—\$36.2 billion; Brown & Williamson Tobacco Corp.—\$17.5 billion; Lorillard Tobacco Co.—\$16.2 billion; and Liggett Group, Inc.—\$790 million. Rick Bragg, *Tobacco Lawsuit in Florida Yields Record Damages*, N.Y. TIMES, July 15, 2000, at A1.

⁷ Barry Meier, *Tobacco Industry Loses First Phase of Broad Lawsuit*, N.Y. TIMES, July 8, 1999, at A1.

⁸ Catherine Wilson, *Tobacco Loses First Class Action Suit*, THE COM. APPEAL, Apr. 8, 2000, at A1.

⁹ *Id.*

¹⁰ Daniel Wise, *Tobacco Fee Bond Issue Planned*, THE RECORDER, Apr. 23, 1999, at 1.

Florida smokers could conceivably exceed \$1 trillion, dwarfing the punitive damages verdict. Moreover, there are other states where an *Engle* style class action could be played out.

While it is certainly possible that no other state judiciary will choose to grapple with the management of a large class action such as *Engle*, it seems more likely that at least some of the forty-nine other state judiciaries will find that their injured citizens are entitled to the same compensation as Florida's.

Had the Florida Legislature not intervened at the eleventh hour with a cap on the appeal-bonding requirement of the lesser of \$100 million or 10% of net worth per defendant,¹¹ the tobacco industry would have had to raise approximately \$164 billion (\$145 billion plus double the statutory interest rate). The bonding requirement for appeal is designed to secure a judgment during the appeals process and, up until now, had applied to every other tort defendant/appellant in Florida.¹² The state reportedly took the action to protect its own \$13 billion settlement with the tobacco industry from the uncertainties of bankruptcy.¹³ Meanwhile, other settling states hired bankruptcy counsel to investigate potential scenarios.¹⁴

While the *Engle* punitive damages awards may be reduced on appeal, the likelihood of *reversing* the verdicts or decertifying the class is remote. After a two-year civil trial featuring over 150 witnesses and thousands of objections, appellate courts will have an enormous transcript to review. It is hard to imagine how Florida's Third District Court of Appeal and the Florida Supreme Court might meaningfully differentiate between harmless errors and reversible errors that would have changed the result. The jury, by all indications, absorbed a tremendous amount of information, deliberated with care, and rejected virtually every argument the tobacco industry made in the course of the trial.

Furthermore, the class was actually defined by Florida's Third District Court of Appeal,¹⁵ which, along with the Florida Supreme Court,¹⁶ twice rejected attempts to decertify or otherwise derail the class. While certainly not impossible, it would seem odd if the Florida Supreme Court were to maintain the action for the duration of what may have been the

¹¹ H.B. 1721, 102th Leg., Reg. Sess., 2000 Fla. Laws ch. 128.

¹² *Id.*

¹³ *Id.*

¹⁴ Henry Weinstein & Myron Levin, *States Brace for the Threat of Tobacco Suit Bankruptcy*, L.A. TIMES, Mar. 20, 2000, at A1.

¹⁵ R.J. Reynolds Tobacco Co. v. Engle, 672 So. 2d 39 (Fla. Dist. Ct. App. 1996).

¹⁶ R.J. Reynolds Tobacco Co. v. Engle, 751 So. 2d 51 (Fla. 1999); R.J. Reynolds Tobacco Co. v. Engle, 682 So. 2d 1100 (Fla. 1996).

longest jury trial in American civil litigation only to decertify the class after the verdict has been rendered.

II. SETTLEMENT DEBT

The tobacco industry has quite a bit more to contend with than appealing the *Engle* verdict. First and foremost, the industry agreed to pay the states about \$10 billion per year forever, to buy peace in the wake of a flurry of lawsuits seeking Medicaid cost recovery and other compensation for financial injuries to the states as well as violations of consumer protection laws.¹⁷ Under a separate agreement, the industry also owes over \$8.2 billion to the outside counsel retained by the states.¹⁸ These staggering obligations might be just the start of tobacco industry settlement burdens, depending on how pending and future claims are handled.

While expensive, the settlements with the states may be seen as a shrewd strategy for the tobacco companies because it ties state settlement revenue to sales of tobacco products, creating a common interest among the states and the industry.¹⁹ It was precisely this sort of common interest that motivated Florida's Legislature and Governor to change the rules of the game to benefit the tobacco industry, altering the appeals bond requirement weeks before the expected punitive damages award in the *Engle* case.

III. PENDING CASES

Big Tobacco's problems certainly do not stop there. Federal Judge Jack Weinstein of the Eastern District of New York has indicated that he would tentatively certify a mandatory national class action consisting of the punitive damages claims of all tobacco-caused personal injuries.²⁰

On September 22, 1999, the U.S. Department of Justice filed an enormous lawsuit against the tobacco industry under the Medicare Recovery Act and the Federal Racketeer Influenced and Corrupt Organizations Act ("RICO"), seeking damages in the hundreds of billions

¹⁷ See Master Settlement Agreement, 13.6 TOBACCO PROD. LITIG. REP. § 223 (1998), available at <http://www.naag.org/tobac/index.html> (last visited Dec. 1, 2001).

¹⁸ See, e.g., Wise, *supra* note 10, at 1.

¹⁹ Master Settlement Agreement, *supra* note 17, § 9(c)(1).

²⁰ See *Simon v. Philip Morris, Inc.*, No. 99 CV 1988, 2000 U.S. Dist. LEXIS 18743 (E.D.N.Y. Nov. 6, 2000).

of dollars and disgorgement of ill-gotten gains.²¹ While the trial court dismissed the medical cost recovery claim, it allowed the RICO disgorgement claim to proceed to trial. The Justice Department's experts have estimated the relevant ill-gotten gains to be as high as \$926 billion.²²

In 2001, the White House spokesperson, Ari Fleischer, revealed that the Bush administration was attempting to engage the tobacco industry defendants to the action in a settlement dialogue while still pursuing the litigation.²³ If either of these tracks results in success for the government, this could force the tobacco industry to bear another large financial obligation and possibly place strong pressure on individual companies to seek bankruptcy protection.

There are also hundreds of individual smokers' lawsuits against the industry pending. Encouraged by the *Engle* verdict, thousands more will likely follow. From 1999 through 2001, four jury verdicts in California and Oregon produced three punitive damages awards ranging from \$20 million to \$100 million.²⁴ In 2001, a Los Angeles Superior Court jury awarded an individual lung cancer plaintiff an astounding \$3 billion punitive damages award against Philip Morris that was subsequently reduced to \$100 million by the trial judge.²⁵ While none of these verdicts, all presently under appeal, by themselves have the potential to financially threaten the tobacco industry, merely managing the defense of thousands of individual cases could prove impossible for the industry both logistically and financially. This is particularly true if the industry is forced to mount a trial defense in hundreds of such cases each year.

The tobacco industry could pay many hundreds of billions of dollars if addicted consumers were willing to pay three, four, or five times as much as they do now for the defendants' cigarettes. The demand for cigarettes, however, is in fact somewhat inelastic, and the ability of

²¹ See *In re Tobacco/Governmental Health Care Costs Litig.*, 76 F. Supp. 5, 7 (D.D.C. 1999) ("On September, 22, 1999, the United States entered the fray by filing a lawsuit in this Court alleging that it was injured as a result of largely the same misconduct as had been alleged in the complaints filed by the foreign governments and by the union trust funds.").

²² See Edward Walsh, *Witness: Big Tobacco Made Millions Illegally*, WASH. POST, Nov. 21, 2001, at A3.

²³ Ari Fleischer, White House Briefing (June 20, 2001).

²⁴ See *Boeken v. Philip Morris, Inc.*, No. BC 226593 (Cal. Super. Ct. L.A. County June 6, 2001); *Whiteley v. Philip Morris, Inc.*, No. 303184 (Cal. Super. Ct. S.F. County Mar. 20, 2000); *Henley v. Philip Morris, Inc.*, No. 995172 (Cal. Super. Ct. S.F. County Feb. 8, 1999); *Williams v. Philip Morris, Inc.*, No. 970503957 (Ore. Cir. Ct. Multnomah County Mar. 30, 1999).

²⁵ *Boeken*, No. BC 226593.

cigarette manufacturers to raise revenue by raising prices is limited.²⁶ At some point, many consumers will choose to quit or opt for less expensive nicotine replacement therapies, or perhaps they will opt to purchase tobacco products from new tobacco companies that do not yet carry the liability burden of the current dominant industry players.

IV. A WORST-CASE SCENARIO FOR THE TOBACCO INDUSTRY

The convergence of the various streams of financial pressures caused by these legal woes may eventually force one or more tobacco companies to seek bankruptcy protection under Chapter 11 of the Bankruptcy Code.²⁷ Under Chapter 11, a filing company continues to operate under court approval of a reorganization plan as a "debtor-in-possession."²⁸ Such a filing would present great challenges to the court. One daunting issue is the sheer number of potential claimants. As American tobacco-caused deaths and diseases now exceed one million every year, the number of potential claims is simply staggering. Handling these claims, from an administrative point of view, would be a massive undertaking.

Foremost among the difficulties for the court approaching a tobacco bankruptcy is the issue of future torts. The parties to the tobacco bankruptcy would be reorganizing a company or companies as debtors-in-possession in order to engage in precisely the same sort of activity that caused the tort liability in the first place. How could they continue to do business to pay off prior liability after the bankruptcy filing if they are simply creating future liability at bankrupting levels in the process?

The problem relates to the requirement of "feasibility" under the Bankruptcy Code.²⁹ The court cannot confirm a plan for reorganization if it is likely to result in "liquidation, or the need for further financial reorganization, of the debtor or any successor to the debtor under the plan."³⁰ The court would need to take into account the value of future tort claimants whose claims have yet to mature in determining the feasibility

²⁶ Jeffrey E. Harris, *American Cigarette Manufacturers' Ability to Pay Damages: Overview and Rough Calculation*, 5 TOBACCO CONTROL 292 (1996).

²⁷ 11 U.S.C. §§ 1101-74 (2000).

²⁸ *Id.* § 1101.

²⁹ *Id.* § 1129(a)(11).

³⁰ *Id.*

of the reorganization plan.³¹ If the plan does not negate the likelihood of substantial future liability, then it is unlikely to be confirmed by the court.

The importance of creditors being paid any significant amount versus the feasibility of a plan where liability is continually created will have to be weighed. If there is an obvious place where the public health community may have a voice in such bankruptcy proceedings, it is in determining whether a particular plan is feasible. If tobacco companies are allowed to continue production—but in the least tortious way—an analysis will have to be made to determine what aspects of production and marketing create the greatest potential liability.

To reduce the possibility that future sales would create their own massive liability, the bankruptcy court might well fashion a quasi-regulatory regime that would require the manufacturer to make the product as safe as possible, limit marketing and promotional activities, and compel full disclosures to consumers that would tend to significantly reduce the possibility of future torts.

The question of eventual bankruptcy for one or more tobacco companies is hardly settled. With Congressional intervention or a reversal of fortune in the courts, the industry could survive this spate of lawsuits and continue to thrive well into the twenty-first century. However, the increasing availability of documentary evidence of industry wrongdoing and an energized plaintiffs' bar following several large punitive damages verdicts makes it hard to believe that Big Tobacco can come up with new and effective defense strategies to protect it from jurors as well-informed as those in the successful Florida, Oregon, and California cases.

If a Chapter 11 tobacco company filing were eventually to occur, how the bankruptcy plays out will likely be heavily influenced by the judge overseeing the case and how much he or she will be willing to address concerns such as public health and continued liability. Should the court take into account those considerations, as we believe it would be required to do, it could transform the tobacco industry more deeply than any legislative or regulatory agency.

³¹ See, e.g., *In re Aquaslide 'n' Dive Corp.*, 85 B.R. 545 (B.A.P. 9th Cir. 1987).